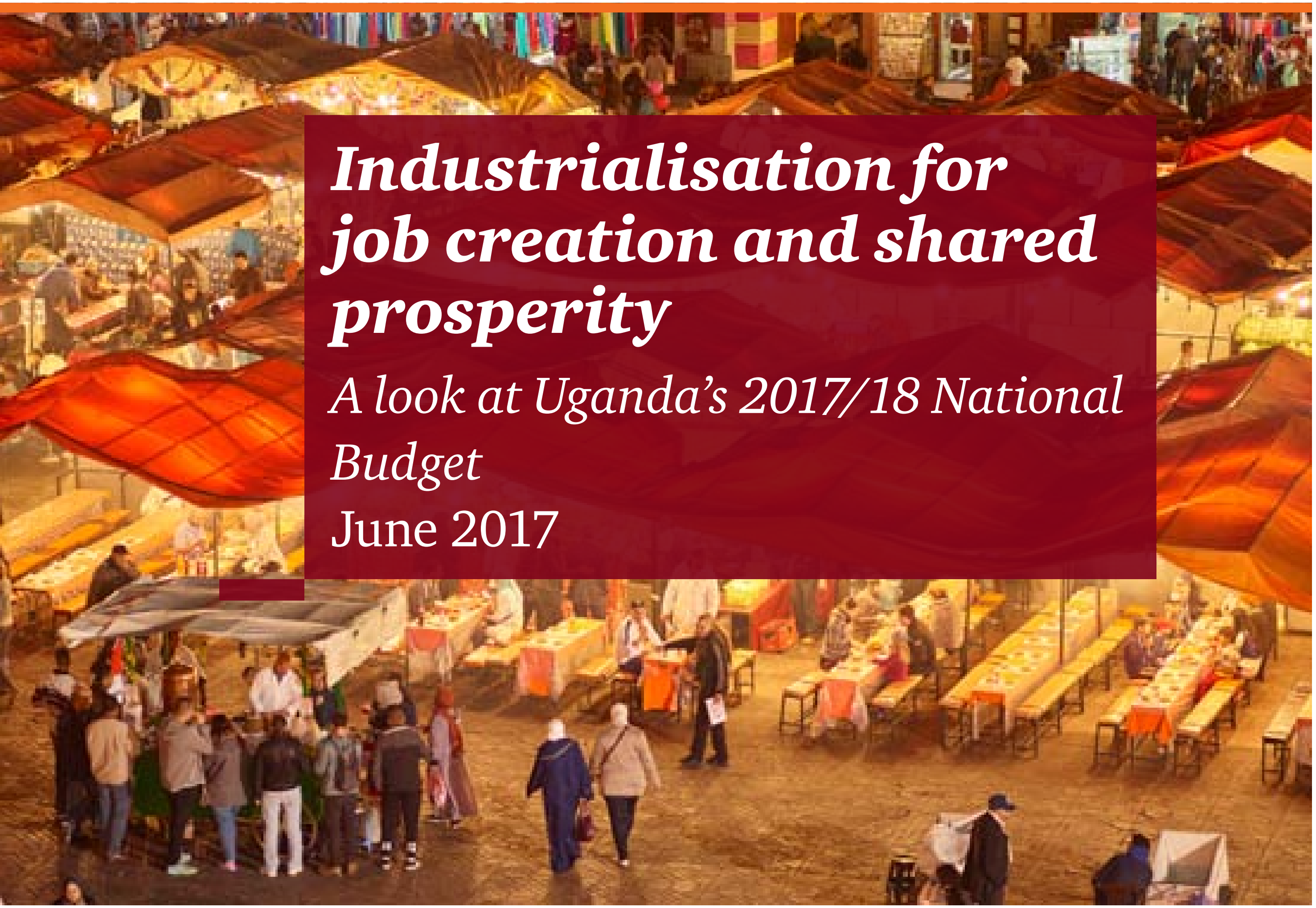

Industrialisation for job creation and shared prosperity

A look at Uganda's 2017/18 National Budget

June 2017

Welcome

Please find enclosed summarised highlights based on the speech by the Minister of Finance and Economic Planning on 8th June 2017.

We hope that you will find this publication helpful, and look forward to your comments.

In this bulletin

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The Economy

Global economic growth

According to IMF's World Economic Outlook, April 2017, global economic growth is expected to rise from 3.1 percent in 2016 to 3.5 percent in 2017 and 3.6 percent in 2018. This is on account of the recovery of commodity prices buoyed by stronger activity and expectations of more robust global demand.

However, the outlook has also identified the following structural impediments to a stronger global recovery - low productivity growth and high income inequality, inward-looking policies which threaten global economic integration, a faster-than-expected pace of interest rate hikes in the United States which could tighten financial conditions elsewhere, with potential further U.S. dollar appreciation straining emerging market economies whose exchange rate pegs to the dollar.

In Europe, growth remained strong in the United Kingdom, with spending showing resilience in the aftermath of Brexit. In the Euro area, growth in countries such as Germany and Spain was strong as a result of domestic demand. Mixed results were reported in the emerging markets where countries such as China registered strong growth while others such as India slowed down and Brazil continued in deep recession.

In Africa, recovery has been slow in the country's largest economies - Nigeria, South Africa, Angola - due to insufficient adjustment to low commodity prices and policy uncertainty, particularly in South Africa.

Sub Saharan Africa (SSA)

Economic growth in SSA is expected to decline further to 1.4% in 2017 from 3.4% in 2015. This is primarily due to drought, an unstable political environment in certain countries and low prices of crude oil that have affected the export earnings of oil producing countries.

East African Community

As shown below, economic growth in East Africa remained strong in spite of drought in Uganda and Kenya.

Table of key economic indicators FY16/17, brackets FY15/16

	UG	KE	TZ	RW
GDP Growth	3.9% (4.7)	6.1% (5.6)	7.2% (7.0)	6.0% (6.0)
Overall inflation	6.8% (6.6)	7.0% (6.6)	5.0% (5.6)	4.9% (4.4)

The growth was supported by high infrastructure investment particularly in Kenya and Uganda, a boost in agriculture in Rwanda and growing domestic demand in Tanzania.

The region however continues to be affected by political instability in Burundi and South Sudan. Headline inflation in the region remained in single digit with Tanzania registering the lowest inflation rate at 5.0%.

EAC: Ease of doing business

Compared to its regional peers, Uganda has performed relatively poorly in the doing business rankings, particularly against neighbors Rwanda and Kenya, but has performed better than Tanzania and Burundi, as shown below.

2017 Doing Business Rankings - EAC

Country	Ranking 2016	Ranking 2017	Change in rank
Rwanda	62	56	+6
Kenya	108	92	+16
Uganda	122	115	+7
Tanzania	139	132	+7
Burundi	152	157	-5

Source: World Bank Doing Business Report, 2017

Rwanda in particular made remarkable progress on certain indicators such as getting credit where it was ranked 2nd globally and registering a property where it ranked 4th.

Uganda's economic performance

Uganda's economy has continued growing but at a slower pace, registering an annual growth rate of 4.5% in the five years to FY15/16, compared to the 7% achieved during the 1990s and early 2000s.

This trend continued in FY16/17 which saw the economy grow by only 3.9%, well below the government's initial projected growth target of 5.5%. However, this still compares well to the estimated 2017 average Sub-Saharan Africa growth rate of 1.4%.

The slower growth rate has been attributed to a number of factors, including the drought, the civil unrest in South Sudan and Burundi, slow recovery in Europe and constrained private sector growth.

In FY 16/17, the country continued to grapple with high interest rates resulting in a number of businesses suffering distress.

However, commercial bank lending rates did ease slightly over the year, with the weighted average UGX lending rate declining from 24.3% to 22.5% (August 2016 to March 2017) and the weighted average foreign currency lending rate declining from 9.5% to 8.1% (July 2016 to March 2017).

This was in part driven by the Bank of Uganda progressively lowering the Central Bank Rate (CBR) by 400 basis points to 11% over the course of the year up to April.

Headline inflation reached 6.8% as at April 2017 (the May figure has increased to 7.2%). From the second quarter this has been fueled by a surge in food crop prices as an after-effect of the prolonged drought.

Over the period March to December 2016, Uganda's total public debt stock increased by 14% from UGX 27.4 trillion (USD 8.1 billion) to UGX 31.4 trillion (USD 8.7 billion), equating to 33.8% of GDP. Of this the domestic component is UGX 11.5 trillion (USD 3.2 billion) or 37.3%.

This debt burden was the reason cited by major credit rating agencies for revising their outlook for Uganda in the first half of 2017 with Moody's downgrading the long-term issuer rating of the GoU from B1 to B2.

Nonetheless, the government is optimistic about the country's economic growth outlook, projecting the economy to rebound to annual growth rates of 7% in the medium term driven largely by large public sector

	FY15/16	FY16/17
GDP Growth	4.7%	3.9%
Total budget in UGX	23.9 trillion	26.3 trillion
Domestic revenue % of GDP (incl. oil)	13.8%	14.4%
Expenditure as % of GDP	20.1%	20.9%
Headline inflation	6.6%	6.8% (year to April)
Public debt in UGX	27.4 trillion (Mar 16)	31.4 trillion (Dec 16)
Domestic borrowing as % GDP	2.3%	0.9%
Fiscal deficit as a % of GDP (incl. grants)	-4.9%	-3.5%

Source: Budget speech and Background to the budget FY 17/18

infrastructure projects and construction of oil-related infrastructure.

Specific growth targets for FY17/18 and FY18/19 are 5.0% and 6.0% respectively. However the Government's tax collection capacity, rising infrastructure costs and public debt, regional instability, climate change and corruption remain challenges to Uganda's upward growth trajectory over the longer term.

Fiscal performance

Budget in total

Projected outcome for FY16/17

The projected outcome for FY16/17 shows a significant reduction in the expected fiscal deficit, from UGX 6,113 billion (6.6% of GDP) to 3,171 billion (3.5% of GDP).

This is primarily due to lack of uptake on the externally financed development budget, following the suspension of World Bank lending and lower than expected disbursements on project loans. The level of external net borrowing is reduced accordingly.

Although domestic revenue is shown as exceeding budget, there is actually a shortfall in URA collections (see following page) which was filled by increased domestic borrowing (exceeding budget by UGX 251 billion).

Budget for FY17/18

The total budget value is UGX 29.0 trillion which is 10.0% up on FY16/17. Domestic revenue will fund 67.5% of the total outgoings, up from 62.1% budgeted in the prior year. The planned deficit is UGX 5,606 billion (5.6% of projected GDP), which will be funded by increased domestic borrowing of UGX 954 billion along with external lending.

Budget support grants continue to dwindle (to UGX 35 billion), while project grants have more than doubled to UGX 1,601 billion. The Petroleum Fund will be drawn upon to the extent of UGX 125 billion to develop roads serving the Lake Albert oil fields.

	FY16/17 Budget UGX b	FY16/17 Projected UGX b	FY17/18 Budget UGX b
INCOMING			
Domestic revenue	12,914	13,012	15,062
Grants	1,766	1,027	1,636
Budget support	276	274	35
Project	1,490	753	1,601
Borrowing (= fiscal deficit)	**6,113**	**3,171**	**5,606**
Domestic (net)	596	847	954
External (net)	5,517	2,324	4,527
Petroleum Fund withdrawal			125
TOTAL INCOMING	**20,793**	**17,210**	**22,304**
OUTGOING			
Sector allocations	18,408	14,656	19,327
Recurring (excl interest)	7,577	7,581	7,885
Development	9,226	6,490	10,167
Net lending/repayment	1,605	585	1,275
Debt servicing	2,385	2,554	2,977
Interest	2,023	2,356	2,676
Domestic arrears	362	198	301
TOTAL OUTGOING	**20,793**	**17,210**	**22,304**
Domestic debt refinancing	4,978		4,998
Appropriation in aid (MDAs)	672		757
External debt repayments			949
Adjustment	-82		
TOTAL RESOURCE ENVELOPE	**26,361**		**29,008**

Source: MOFPED Background to the Budget, Tables 4.8, 7.3 and 21, Budget speech

Domestic revenues

Projected revenue outcome for FY16/17

Although the table to the right indicates that the domestic revenue target for the current year will be met, the actual URA tax collection targets are set differently and are projected to result in a UGX 377 billion shortfall as follows:

	FY16/17 Target UGX b	FY16/17 Projected UGX b	Shortfall UGX b	Shortfall %
Tax revenue	12,929	12,552	-377	-2.9%
Non tax revenue	330	330	-	-
Total revenue	13,259	12,882	-377	-2.8%

The shortfall largely arises from corporate income tax, international trade taxes and excise duty, with this being attributed to the economic slowdown, lower than expected import volumes and reduced international calls and talktime in the telecoms sector. At the same time it is worth noting that tax collections for the current year have grown by 13.8% compared to FY16/17. The URA exceeded their targets in respect of PAYE and domestic VAT.

It is notable that the tax revenue to GDP percentage has increased to 13.7%, which means that for FY16/17 the Government met its target of increasing this ratio by 0.5% per annum until FY21/22.

Budgeted revenues for 2017/18

The URA revenue collection target for the coming year is UGX 15.0 trillion, representing a UGX 2.0 trillion or 15.8% increase over the projected outcome for the current year.

Domestic revenues summary

	FY15/16 Actual UGX b	FY16/17 Budget UGX b	FY16/17 Projected UGX b	FY17/18 Budget UGX b	Increase v. prior year %
Tax revenue	11,059	12,480	12,552	14,682	17.0%
Non tax revenue	318	302	330	380	15.2%
Oil revenues	121	132	130	0	
Total domestic revenue	11,498	12,914	13,012	15,062	15.8%
Tax revenue % of GDP	13.2%		13.7%		0.5%

Source: MOFPED Background to the Budget, Tables 7.3, 20 and 21

The URA is to be tasked with collection of all non-tax revenues going forward (meaning that MDAs will no longer collect service fees, etc.)

Approximately UGX 185 billion of the revenue increase is expected to come from the specific tax policy measures introduced for FY17/18, including changes to the excise duty rates for cigarettes and beverages, application of rental estimates for non-compliant landlords, the re-introduction of VAT on wheat grain, the 15% withholding tax on gaming winnings and changes to selected import duties under the EAC Common External Tariff (see further details in the Tax Amendments section).

Along with ongoing domestic revenue mobilisation initiatives and an expected upturn in the economy, the following policy measures are also expected to increase tax collections:

- Implementing a comprehensive joint risk compliance strategy and more robust risk identification and management mechanism
- Strengthening aspects of the international tax regime;
- Investment in third party information matching;
- Review and updating of the URA e-platforms;
- Strengthening compliance management through enhanced data gathering and analysis;
- Improved debt recovery and arrears management.

Government spending

Sector allocations for FY17/18

The planned government spending for the coming year, inclusive of external financing but excluding interest costs, totals UGX 19,327 billion and is allocated to the specific sectors as set out in the table. The addition of interest brings the total to UGX 22,002 billion.

Works and Transport continues to be the main recipient in line with the Government's focus on infrastructure development as a key platform to grow the economy. The biggest vote within this sector remains with UNRA and the improvement of Uganda's roading system.

The budget speech refers to the key primary growth sectors as Agriculture, Tourism and Extractives, along with increased industrialisation via agro-processing. However, of these only the Tourism sector appears to have benefitted from a significant vote increase.

Plans for improving public sector efficiency and support to technical innovation (such as the proposed UGX 43 billion Innovation Fund and ICT initiatives) are reflected in the Public Sector Management and ICT sector increases.

Of note is the significant 32% increase in interest costs, the bulk of which (UGX 2,025 billion) relates to domestic borrowing.

While the planned increase in domestic debt for FY17/18 has been limited to UGX 954 billion (to keep it below 1% of GDP and avoid putting pressure on interest rates and the domestic credit supply), the continuing increase is of some concern.

Sector allocations

	FY16/17 Budget UGX b	Share %	FY17/18 Budget UGX b	Share %	Increase %
Works and Transport	3,824	18.7%	4,587	20.8%	20.0%
Education	2,447	12.0%	2,501	11.4%	2.2%
Energy & Minerals	2,377	11.6%	2,320	10.5%	-2.4%
Health	1,827	8.9%	1,824	8.3%	-0.2%
Security	1,579	7.7%	1,473	6.7%	-6.7%
Public Sector Mgmt	1,274	6.2%	1,450	6.6%	13.8%
Justice/Law & Order	1,104	5.4%	1,159	5.3%	5.0%
Accountability	962	4.7%	896	4.1%	-6.9%
Agriculture	823	4.0%	829	3.8%	0.7%
Water & Environment	690	3.4%	632	2.9%	-8.4%
Public Admin	532	2.6%	563	2.6%	5.8%
Legislature	470	2.3%	484	2.2%	3.0%
Social Development	193	0.9%	176	0.8%	-8.8%
Lands, Housing & Urban Dvpmt	147	0.7%	140	0.6%	-4.8%
Tourism, Trade & Industry	90	0.4%	117	0.5%	30.0%
ICT	55	0.3%	104	0.5%	89.1%
Science, Tech. & Innovation	14	0.1%	72	0.3%	414.3%
Total (excluding interest)	**18,408**		**19,327**		**5.0%**
Interest	2,023	9.9%	2,675	12.2%	32.2%
Total (including interest)	**20,431**	**100.0%**	**22,002**	**100.0%**	**7.7%**

Source: MOFPED Background to the Budget Table 7.4

Tax Amendments

Background

Our recent Tax Watch summarised the proposed tax amendments per the Amendment Bills issued in late March. The revised Bills, which are understood to be final (subject to Presidential assent), contain a number of changes which are outlined below. All amendments are stated to come into effect from 1 July 2017.

Income Tax

Estimates of rental income

The original Bill introduced a provision for the Minister of Finance to prescribe (via statutory instrument) estimates of rent in specific locations that the URA can apply to assess rental income where a landlord has either failed to declare such income or the URA considers that the declared amount is misleading.

There is now an additional provision requiring the Minister's statutory instrument to be approved by Parliament before coming into force.

In addition, it is now required that all rental agreements shall be executed and effected in Uganda shillings. It is a little puzzling why such a requirement has been included in a taxing statute (as opposed to the exchange control regulations) and questions arise as to how this will be enforced. There is no transitional provision so the position for existing lease agreements is also unclear.

Exemption for Bujagali Hydro Project

The proposed tax exemption for the income of the Bujagali hydro power project has been reduced to a period of five years. This will now run until 30 June 2022 (compared to the original 16 year period running to 2033). Given that the intention of the exemption was to reduce the power tariff for consumers, there may be a reasonable expectation for the exemption period to be extended once the initial five years expires.

Exemption for SACCO's

A new 10 year income tax exemption is introduced for all Savings and Credit Cooperative Societies. The stated intention is to encourage financial inclusion and promote individual savings. This follows the measure last year where the tax arrears of SACCO's as at 31 December 2015 were waived.

Initial allowance for plant and machinery

The reinstatement of the 50% initial allowance for plant and machinery first used outside of Kampala has been clarified slightly. The allowance is not permitted for eligible machinery used within a 50km radius of Kampala and this is now stated more clearly to mean 50 km from the "boundaries of Kampala".

Reporting of financial transactions

The original Bill proposed to introduce a requirement for banks and other financial institutions such as forex and money transfer agents to file a monthly report to the URA disclosing details of all transactions above UGX 20 million. This was seen as imposing an unnecessary additional burden on financial institutions and accordingly the provision has been removed.

VAT

Concession for aid-funded projects

The provision allowing for deemed payment of VAT for contractors carrying out aid-funded projects, as introduced last year, is proposed to be extended to supplies made to the Government. This proposal remains but now includes a definition of "aid-funded project", something that was missing from the original provision in 2016.

An aid funded project is defined as "a project financed by a foreign government or a development agency through loans, grants and donations". Hence it appears that projects funded by private aid are not entitled to the concession. The definition is stated to apply to cases involving supplies to the Government, but we assume that it will also be applied for supplies made to contractors.

Credits for large cash payments

The original Bill proposed to deny an input tax credit for supplies exceeding UGX 100 million paid in cash. This proposal has now been removed.

Due dates for payment of VAT

The original Bill reinstated the old VAT Act provision detailing the specific due dates by which VAT is required to be paid. This has been removed from the final Bill. As the prior payment due dates were repealed by the Tax Procedures Code Act in 2016, this means that the legislation remains without prescribed VAT payment dates.

Additional VAT exemptions

The list of new VAT exemptions has been amended to comprise the following:

- animal feeds and premixes;
- crop extension services;
- irrigation works, sprinklers, and ready to use drip lines;
- deep cycle batteries and composite lanterns;
- menstrual cups
- Agriculture Insurance Premium or Policy.

The proposed exemption for tourist arrangement services, access to tourist sites and tour guide and game driving services has been removed. The Agriculture Insurance exemption is a new item.

Tax Procedures Code Act

Filing of provisional returns

The proposed semi-annual and quarterly due dates for the filing of provisional tax returns by entities and individuals respectively have been removed. As indicated in our Tax Watch, the original proposal appeared to confuse the return filing dates with the tax payment dates, and was inconsistent with section 112 of the Income Tax Act.

The Bill now simply includes a filing provision that is essentially identical to section 112(4) of the ITA. This requires a single annual provisional tax return to be filed by the due date for the first instalment payment (e.g. for entities 6 months after the start of the year). This restores the status quo.

Returns for gaming tax

The original Bill proposed a requirement for payers of gaming tax to file a weekly tax return. This has now been removed.

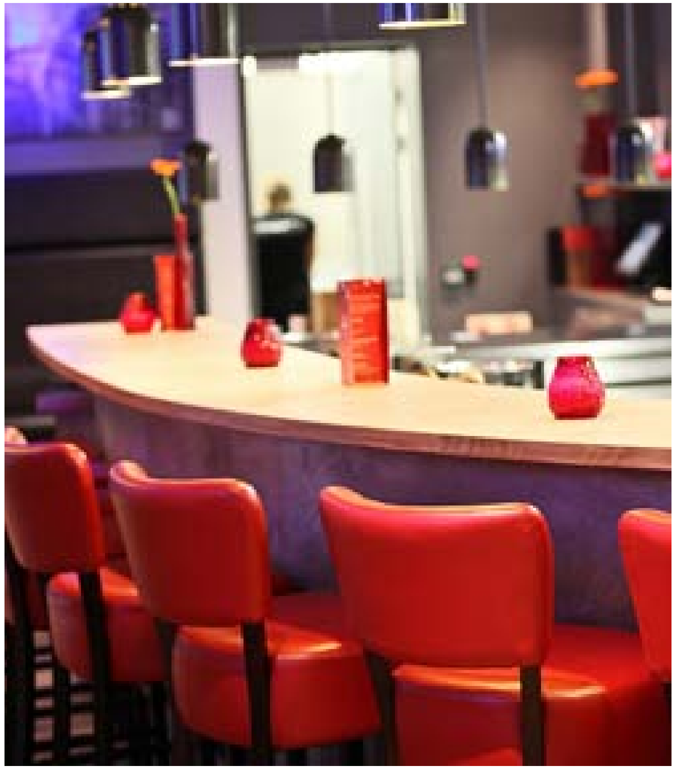
Excise Duty Act

The rate changes proposed in the original Bill have been amended as follows:

- Imported cigarettes are subject to increased rates of UGX 75,000 per 1,000 sticks for soft cap and UGX 100,000 per 1,000 sticks for hinged lid respectively.
- The proposed new minimum specific duty rate for beer made from at least 75% local raw materials has been decreased from UGX 700 per litre to UGX 650 per litre.
- The proposed UGX 5,000 per litre specific duty rate for spirits made from local raw materials has been removed (meaning that the ad valorem rate of 60% continues).
- The proposed rate change for wines not made from local raw materials has been removed.
- The proposed nil rate for sugar confectionaries has been removed (meaning that the current 20% rate continues).

Import duties

The Budget speech refers to agreed changes to the EAC Common External Tariff (CET), with details to be published in the EAC Gazette. The Background to the Budget indicates potential rate changes for crude oil palm and clinker, and expanding the scope of the 1.5% infrastructure levy. It also states that a comprehensive review of the CET is being undertaken in connection with the ability for Partner States to apply alternative protectionist rates.



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